

**MINUTES  
of the  
FIRST MEETING  
of the  
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

**June 17, 2014  
Room 307, State Capitol  
Santa Fe**

The first meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2014 interim was called to order by Representative Jim R. Trujillo, chair, on Tuesday, June 17, 2014, at 10:10 a.m. in Room 307 of the State Capitol in Santa Fe.

**Present**

Rep. Jim R. Trujillo, Chair  
Sen. Jacob R. Candelaria  
Rep. Larry A. Larrañaga  
Sen. Carroll H. Leavell  
Sen. Bill B. O'Neill  
Rep. Jane E. Powdrell-Culbert  
Rep. William "Bill" R. Rehm  
Sen. William P. Soules  
Rep. Luciano "Lucky" Varela

**Absent**

Sen. George K. Munoz, Vice Chair  
Sen. Sue Wilson Beffort  
Sen. Steven P. Neville  
Rep. Henry Kiki Saavedra

**Advisory Members**

Rep. Donald E. Bratton  
Sen. Carlos R. Cisneros  
Rep. Miguel P. Garcia  
Rep. Roberto "Bobby" J. Gonzales  
Sen. Timothy M. Keller  
Rep. Patricia A. Lundstrom  
Sen. John C. Ryan

Rep. William "Bill" J. Gray  
Sen. Stuart Ingle  
Rep. Emily Kane  
Rep. Tim D. Lewis  
Sen. Mary Kay Papen  
Sen. William H. Payne  
Sen. Michael S. Sanchez  
Rep. Sheryl Williams Stapleton

**Staff**

Amy Chavez-Romero, Assistant Director for Drafting Services, Legislative Council Service (LCS)  
Ric Gaudet, LCS  
Randy Taylor, LCS

**Guests**

The guest list is in the meeting file.

**Handouts**

Handouts and other written testimony are in the meeting file.

**Tuesday, June 17**

**Status Report from the State Investment Council (SIC)**

Steven K. Moise, state investment officer, and Vince Smith, deputy state investment officer, SIC, gave an update on the investments and activities of the SIC during the seven months since the committee met in 2013. Mr. Moise reported that the total assets under SIC management as of June 17, 2014 was \$19.6 billion. Those assets have grown more than \$5 billion since 2010, when the council was statutorily restructured and significant governance and investment reforms were implemented.

The main state funds managed by the SIC include the Land Grant Permanent Funds (LGPF), Severance Tax Permanent Fund (STPF), Tobacco Settlement Permanent Fund (TSPF) and Water Trust Fund (WTF). The LGPF currently are valued at \$13.7 billion, with distributions in fiscal year 2015 to be set at \$596 million. Looking forward to fiscal year 2017, even with the scheduled drop in the distribution rate from 5.5 percent to five percent, distributions from the funds are expected to be around \$640 million. The STPF, with \$4.5 billion in assets, continues to have difficulty growing because contributions to the fund are irregular and too small to grow the fund. The fund is growing slowly due to impressive investment gains, but its valuation is still below the 2007 high of \$4.8 billion. The TSPF currently has \$194 million in assets. Statutory contributions to the fund have not been made since 2008 due to legislative appropriations for other purposes. In addition, revenue from the tobacco settlement with the major tobacco manufacturers has been reduced because the state was found to not be in complete compliance with the settlement agreement. The WTF has \$48 million in assets, with a required statutory \$4 million distribution per year. There are no statutory provisions for contributions to the fund, however. Actuarial studies have predicted that by 2034, the fund has a good chance of being completely depleted.

Mr. Smith discussed the recent investment return history of the SIC. The SIC has set an annual expected rate of return of 7.5 percent, which he feels is a realistic, but challenging, goal to reach. The SIC is continuing its asset reallocation plan by lowering equity holdings and reducing volatility and increasing income-producing assets. The SIC goal is to produce consistent returns rather than speculative gains and losses. The current asset allocation of the SIC looks very different than the 2009 allocation. According to the Sharpe ratio, which compares the five-year annualized return versus risk exposure, SIC assets are performing better than the national average for similar-sized funds. New Mexico has slightly higher-than-average returns and lower-than-average risk exposure.

Mr. Moise finished the presentation by discussing proposed legislation for consideration, including an STPF funding formula adjustment, SIC-enabling-statute updates and staffing flexibility.

Questions and comments from committee members included the following.

- Why are contributions to the STPF so volatile? Charles Wollmann, director of communications, SIC, said that severance tax bonds are issued based on severance tax collections the previous year, but contributions to the fund are based on current year receipts, after accounting for outstanding bonds issued. Volatility in the oil and gas sector can mean that the STPF gets no contributions one year followed by a windfall contribution the next year. In addition, under current statute, 95 percent of the severance tax bonding capacity is spent on issuing bonds, whereas historically 50 percent of that capacity was distributed to the STPF. Mr. Moise said that the SIC will soon reconvene the STPF funding study group to develop recommendations for obtaining regular contributions to the fund. A legislator commented that reform of the various funding mechanisms needs to be done incrementally.

- The New Mexico Finance Authority Oversight Committee should hear a presentation from the SIC about the potential depletion of the WTF.

- Although it may be a good idea to repeal the statutory authority for the SIC's unneeded Private Equity Investment Advisory Committee, it might also be a good idea to put into statute its current committees to ensure proper oversight of the state's trust funds.

- Would Congress need to approve a constitutional change to the distribution amount from the LGPF? Mr. Moise said that an attorney general opinion several years ago said that such a change would require congressional approval, but the distribution amount was changed anyway. He said that the SIC has no opinion on the correctness of that opinion. There has been much discussion that adding a distribution to fund early childhood education from the funds would require congressional approval because that change would, in effect, be creating a new recipient and purpose. Committee members requested that members of the New Mexico congressional delegation be consulted about what, if any, congressional approval would be necessary for changes in distribution amounts and recipients.

- Measuring growth of investment funds is not useful unless that growth is measured against the inflation rate.

### **Status Report and Legislative Summary from the Public Employees Retirement Association (PERA)**

Wayne Propst, executive director, PERA, gave a report to the committee of recent activities of the PERA. He began by introducing the newly hired chief investment officer (CIO) for the PERA, Jon Grabel. Mr. Grabel then gave a brief financial summary of the PERA fund to the committee, saying that the fund had reached a new all-time high of \$14.5 billion. In fiscal year 2013, the fund earned 13.25 percent; so far in fiscal year 2014, it has returned more than 15 percent. The PERA is undergoing an asset allocation change to ensure more consistent returns at moderate risk. The PERA fund pays out \$85 million monthly in benefits to members, so it also needs sufficient liquidity to meet those obligations.

Recent actuarial projections of the PERA indicate that the pension system will be 100 percent funded by 2040. New actuarial studies will update that projection in October 2014. The PERA board recently voted to maintain its expected rate of investment return of 7.75 percent, based on experience studies and actuarial recommendations. The new Governmental Accounting Standards Board (GASB) Statements 67 and 68, which will take effect during the next two fiscal years, will place additional burdens on local governments to report their portion of net pension liability. The PERA board decided that it will pay for producing those local actuarial reports. The PERA's accounting firm will also be available to assist local governments in complying with those statements.

Mr. Propst discussed recent legislation enacted to reform the judicial and magistrate retirement plans. The legislation mirrored many of the changes made to regular state and local retirement plans in 2013. Severe underfunding prompted a two-year suspension of cost-of-living adjustments (COLAs) and provided for effective future yearly COLAs of .62 percent. With the recent statutory changes, the judicial retirement system looks to be fully funded by 2041, and the magistrate retirement system will be 88 percent funded by that date.

Questions and comments from committee members included the following.

- What is the status of the back-pay lawsuit for certain state employees? Susan Pittard, general counsel, PERA, said that the state has already made adjustments to current employee salaries, with corresponding changes to PERA contributions. The PERA will soon need to make adjustments to pension benefits to currently retired employees who were plaintiffs in the lawsuit. That will have an actuarial effect on the PERA fund, but the amount has not yet been determined.

#### **Status Report from the Educational Retirement Board (ERB)**

Jan Goodwin, executive director, and Bob Jacksha, CIO, ERB, gave a report to the committee on the activities and investment returns of the ERB. Investment earnings from the previous 12 months were approximately \$1 billion, a net return of 9.8 percent for the year. Portfolio returns equaled or exceeded the actuarial target in most periods measured. The ERB fund reached an all-time high of \$11 billion in April, and strong growth seems to be continuing. The ERB needs to maintain or exceed a 7.75 percent return on investment in order to maintain the actuarial soundness of the fund. Over the past 30 years, the fund has achieved a 9.5 percent return, but in the past 10 years, that rate has been only 6.8 percent, mostly due to the financial crisis of 2007-2009. Since 2009, however, the fund has achieved an investment return of 14.7 percent.

The ERB's goals to maintain at least a 7.75 percent investment return and to minimize the risks of volatility are being attempted through proper asset allocation. The ERB has reduced its public equity holdings from 70 percent in 2006 to about 38 percent today. This allocation reduces volatility significantly while ensuring consistent growth from equities and income-producing assets.

Based on investment returns and legislative changes made in 2013 to benefits and contribution schedules, the ERB is expected to be nearly fully funded by 2043. This actuarial valuation was based partly on experience studies to provide expected benefit expenses. The experience study, completed in 2012, was recently audited for accuracy. The audit validated the findings of the experience study and the actuarial valuation performed in June 2013.

Questions and comments from committee members included the following.

- The ERB staff was asked to provide data on the average age of retirement and the average annual pension benefit. Ms. Goodwin said that the data will need to be separated between K-12 retirees and higher education retirees to be useful. The ERB will provide the requested data at a future IPOC meeting.

### **Status Report on the Retiree Health Care Authority (RHCA)**

Mark Tyndall, executive director, RHCA, gave the committee an update on the activities of the RHCA. The RHCA offers Medicare supplement and pre-Medicare health plans for retired public employees. There are approximately 100,000 active employees contributing to the system and 58,000 covered retirees. The authority operates with \$2.9 million in program support and a \$272 million health care budget.

In 2014, the RHCA attempted to have legislation enacted that would increase employee and employer contribution rates over a period of six years. This rate change would have increased the solvency of the RHCA fund by many years. The RHCA will propose similar legislation for the legislature's consideration in 2015. In addition to legislation, the RHCA is continuing to reform its benefit plans to increase the solvency of the fund, including adjusting premium rates, subsidy levels, age requirements and service requirements. All of the stakeholders involved have contributed to the solvency of the fund.

The RHCA fund currently has \$353.9 million in assets, which are invested by the SIC. The fund will soon be able to have investments in private equity funds, a change recently approved by the SIC.

Questions and comments from committee members included the following.

- There have been many complaints about the RHCA's current prescription provider, Medco. The RHCA should look for a different entity. Mr. Tyndall agreed and said that the RHCA used to contract with ExpressScripts, but due to poor performance and service, the RHCA fired that company and hired Medco. Soon after that switch, ExpressScripts bought Medco. He said that service needs to be improved.

- Some new prescription drugs to combat illnesses that seniors face may be too expensive for retirees to purchase because the RHCA imposes financial disincentives to purchase name-brand prescriptions instead of generics. Mr. Tyndall said that the RHCA requires a lower co-pay

for generic drugs. However, retirees who choose formulary drugs only have to pay a maximum of \$50.00 extra per month.

### **Public Comment**

#### PERA Service Credit Rule Change

Robin Gould, staff representative, Communications Workers of America, and Jean Smith and Jennifer Smith, part-time employees at the Department of Health (DOH), commented to the committee about the PERA's proposed rule increasing the number of hours required to work per month in order to receive full service credit. Ms. Gould said that many public employees work part time to care for family members or because of a disability. The rule change would unfairly target that population. Jennifer Smith said that her office at the DOH is composed of 20 federally mandated part-time employees who do not have the option of becoming full time. The rule change now means that those employees may have to work 40 to 50 years to receive the same retirement benefits they were previously promised at one-half those years. She said that after petitioning the PERA board, the board suspended the rule until further studies were done. Now a modified rule is being proposed, which grants one-half service credit to those employees who are not yet vested and who work fewer than an average of 30 hours per week. Vested employees would continue to earn full service credit for an average of 20 hours per week worked.

Mr. Propst was asked to comment on the proposed rule. He said that several years ago, the IPOC and other legislative committees requested that the PERA do whatever it could through rule changes to increase the solvency of the PERA fund. One of those changes identified by the PERA included modifying the part-time service credit rule. The modified rule was adopted in May 2014. After complaints about the rule surfaced, many PERA board members were concerned that the rule could inadvertently affect some employees unfairly. The board suspended the rule, and a new rule (described above) was proposed. That rule will be voted on by the PERA board on June 26. The old rule would have affected 660 current members. The new rule, which exempts vested members, will affect approximately 240 members.

Questions and comments from committee members included the following.

- This decision is really up to the PERA board to decide and not the legislature.
- How much money will the PERA fund save with this change? Mr. Propst said that there has not been an actuarial study on this rule change. However, any rule change that affects fewer than 300 members will not have much of an impact. He said the rule change is more a matter of principle and not economics.
- Are there any potential legal liabilities associated with this rule change? Mr. Propst said that changes that affect vested members could be legally suspect.
- Public employees should not get the same benefit as other employees for working less and contributing less.

### ERB Financial Solvency and Discount Rate Calculation

Brad Day, board member, ERB, presented concerns he has with how the ERB calculates its discount rate, which could have profound impacts on the perceived and actual solvency of the fund. The ERB uses a discount rate of 7.75 percent to calculate its unfunded total pension liability (TPL). That discount rate is based on its expected average investment earnings. Using that rate, the ERB's unfunded TPL is currently at \$17 billion. However, that projected rate is far too aggressive and full of assumptions and risks. A risk-free rate should instead be used, such as the 30-year treasury bond rate of 3.5 percent. That rate would provide a more accurate measure of unfunded TPL, probably in the \$25 billion to \$40 billion range. In addition, the statutory COLA provisions enacted recently are too risky. The ERB should only provide a COLA when it can afford to, actuarially. He cautioned the committee that not too long ago, Detroit's retirement plan was projected to be 95 percent funded, and now it is seen as a major contributor to the city's bankruptcy.

Questions and comments from committee members included the following.

- What discount rate should be used to calculate the TPL? Mr. Day said that in the private sector, companies are not allowed to use a discount rate higher than the corporate bond rate, currently around four percent. However, in the public sector, most retirement boards use artificially high discount rates to pretend that the state can afford the benefits it has promised.

### **2014 Interim Work Plan and Meeting Schedule Adoption**

Ms. Chavez-Romero presented the proposed work plan and meeting schedule for the committee's consideration. The work plan proposed that during the 2014 interim, the IPOC will:

- receive reports from the ERB and the PERA on current projections related to the solvency of the pension funds for each member plan;
- receive testimony from the ERB, the PERA and the RHCA and, as deemed necessary, their actuaries, employee representatives, fiscal experts and others regarding the status of the applicable funds and investments, investment earnings and fees paid on the investments;
- receive reports from the PERA regarding the legislative retirement plans;
- receive reports from the PERA regarding the magistrate and judicial retirement plans and changes in the retirement plans resulting from legislation enacted during the 2014 legislative session;
- receive reports from the Education Trust Board regarding investment earnings and 529 College Savings Plan program operations;
- review the manner in which investment policy and associated earning benchmarks are set for the investment funds by the governing bodies and investigate how each agency determines

the proportional mix of types of investments, including mutual stock and bond funds, individual stocks and bonds, real estate and private equity, etc. The IPOC will focus on how investment policies for the retirement funds have changed in response to changes in projections regarding program solvency and unfunded liabilities;

- receive reports from the SIC related to the programs of the SIC aimed at enhancing the economic development in the state;

- receive testimony on the investment policies, practices and returns of the economically targeted investment programs of the SIC, particularly the Private Equity Investment Advisory Committee, the Small Business Investment Corporation and the film loan program;

- examine the performance of the investment portfolios of the SIC, the PERA and the ERB and funds in the state treasury in absolute terms and compared to policy benchmarks and comparable funds. This would include the returns on the entire portfolio, the returns on individual segments, including stocks, bonds, real estate and private equity, and all fees paid on the investments;

- receive reports from the Office of the Attorney General, private plaintiffs or others regarding the progress of current litigation and of potential claims by the state and the funds regarding "pay-to-play" allegations and investment fraud, etc.;

- receive reports from the SIC regarding ongoing litigation against the former executive director of the now-defunct Region III Housing Authority;

- receive reports from the Department of Finance and Administration regarding relevant GASB statements; and

- examine other issues related to the investment of public funds and the administration of pensions, as necessary.

The work plan and meeting schedule were adopted, with the caveat that legislators could contact staff if new areas of study were to come up during the interim.

### **Adjournment**

There being no further business, the committee adjourned at 2:33 p.m.